(27)

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1944

No. 1305 85

LORIN A. CRANSON,
Petitioner,

vs.

THE UNITED STATES OF AMERICA,
Respondent.

On Petition for a Writ of Certiorari to the United States Circuit Court of Appeals for the Ninth Circuit.

PETITIONER'S REPLY BRIEF.

LEON DE FREMERY,
Crocker Building, San Francisco 4, California,
Attorney for Petitioner.

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PETITIONER'S REPLY BRIEF.

1. THE GROUNDS ASSERTED BY PETITIONER IN HIS REFUND CLAIMS ARE SUFFICIENT TO SUPPORT ALL CONTENTIONS ADVANCED BY PETITIONER IN THIS SUIT.

On page 9 of its brief the Government makes the statement that

> "* * * since no one of the refund claims filed by the taxpayer (R. 12-23) alleges that Section 501 of the Second Revenue Act of 1940 or Article 115-3 of Treasury Regulations 94 (Appendix, *infra*, pp. 21-23) is unconstitutional, that question is not open to the taxpayer in a suit on the

claims. *Real Estate-Land Title & Trust Co. v. United States,* 309 U. S. 13."

The petitioner's contentions with respect to the unconstitutionality of Section 501 of the Second Revenue Act of 1940 and Article 115-3 of Treasury Regulations 94 are advanced in connection with petitioner's alternative argument that the *loss* actually realized by Honolulu upon the liquidation of its subsidiaries reduced Honolulu's earnings and profits available for dividends.

With respect to this alternative contention, petitioner's claims for refund were specifically based on the ground that 96% of the dividends received from Honolulu Oil Corporation in 1936 were exempt from tax and that "In computing the Corporation's earnings available for taxable dividends, it is necessary to take into account * * * losses upon dissolution during 1936 of wholly owned subsidiaries." (R. 18, 22.)

In *Real Estate-Land Title & Trust Co. v. United States,* 309 U. S. 13, cited by the Government, this Court decided that a claim for refund based solely on the ground that the taxpayer was entitled to an allowance for obsolescence will not support a suit based on the ground that the taxpayer was entitled to a deduction for a loss sustained and not compensated for by insurance or otherwise.

It is apparent that in the instant proceeding the petitioner has not departed from the ground for refund asserted in his refund claim. It is elementary that in support of that ground the petitioner may advance any reasons whatever. It has never been

held that a taxpayer must set forth his entire legal argument in his refund claim.

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2. SECTION 115(h) HAS NO APPLICATION TO THIS CASE.

On pages 11 and 12 of its brief the Government makes the statement:

> "Furthermore, Section 115(h) of the Revenue Act of 1938 * * * refer only to 'earnings or profits' and do not indicate that the rule is to be extended to operating deficits * * *."

And in a footnote on page 11 it is stated:

> "Congress first incorporated the principle (the Sansome rule) completely in Section 115(h) of the Revenue Act of 1938 * * *."

Section 115(h) of the Revenue Act of *1936,* which is the statute controlling the disposition of the present case, reads as follows:

> "**(h) Effect on earnings and profits of distributions of stock.**—The distribution (whether before January 1, 1936, or on or after such date) to a distributee by or on behalf of a corporation of its stock or securities or stock or securities in another corporation shall not be considered a distribution of earnings or profits of any corporation—
>
> "(1) if no gain to such distributee from the receipt of such stock or securities was recognized by law, or
>
> "(2) if the distribution was not subject to tax in the hands of such distributee because it did not constitute income to him within the

meaning of the Sixteenth Amendment to the Constitution or because exempt to him under section 115(f) of the Revenue Act of 1934 or a corresponding provision of a prior Revenue Act.

"As used in this subsection the term 'stock or securities' includes rights to acquire stock or securities."

Section 115(h) merely provides that the distribution by a corporation of its own stock or securities, or stock or securities of another corporation, shall not be considered a distribution of earnings or profits if the distribution is not taxable to the recipient. The purpose of this section was to prevent a corporation from making a tax-free distribution to its stockholders of stock or securities and at the same time contend that it had reduced its earnings available for dividends.[1] Section 115(h) obviously has no bearing whatever on the transfer of corporate earnings in non-taxable reorganizations.

In the Revenue Act of 1938 the words "or of property or money" were inserted after the words "another corporation" in the first few lines of section 115(h), so that it applied not only to a distribution of stock or securities but also of property or money. But it is apparent that the addition of these words in 1938 did not result in this section of the statute incorporating the principle of the *Sansome* case.

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[1]Section 115(h) appeared in its original form as section 203(g) of the Revenue Act of 1924. The reasons for its enactment appear on page 9 of a statement prepared for the use of the Senate Committee on Finance (68th Congress, 1st Session), entitled "Statement of the Changes made in the Revenue Act of 1921 by H. R. 6715 and the Reasons Therefor."

3. THE AMOUNT OF HONOLULU'S DEDUCTIBLE LOSS IS NOT IN ISSUE.

In the footnote on page 10 of the Government's brief it is stated that Honolulu may not again deduct the losses of the subsidiaries taken in prior years on consolidated income tax returns and that in whatever year the loss may be recognized it will be limited in amount. As pointed out in petitioner's brief, page 37 *et seq.*, the recognition of the loss realized by Honolulu on liquidation of the subsidiaries is not merely deferred—it will *never* be recognized for tax purposes. It is by virtue of this very fact that it is claimed that Honolulu's earnings available for dividends, as distinguished from its *taxable net income,* must be reduced at the time of liquidation by the loss actually realized, in order to avoid a serious permanent overstatement of earnings available for dividends.

Dated, San Francisco, California,
July 2, 1945.

LEON DE FREMERY,
Attorney for Petitioner.

Due service and receipt of a copy of the within is hereby admitted

*this*_____*day of July, 1945.*

_____

Solicitor General of the United States,
Attorney for Respondent.